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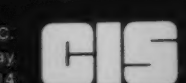

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GROWTH IS NOT ENOUGH: WHY THE RECOVERY OF THE 1980's DID SO LITTLE TO REDUCE POVERTY

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Poverty in the United States is affected by both the performance of the economy and the effectiveness of government programs in responding to the level of poverty generated by the economy. During the 1960s, strong economic growth made a major cause of falling poverty rates. As the economy weakened in the 1970s, however, increases in government transfer programs kept poverty rates lower than they would have been otherwise.

The historical experience of strong growth and declining poverty has caused many to emphasize economic growth as the primary solution to poverty. Unfortunately, research demonstrates that the "trickle down" effect of macroeconomic growth was far less effective against poverty in the 1980s than it had been in earlier decades. If macroeconomic performance had been as effective during the 1980s in reducing poverty as it was in the past, we would have expected a 1989 poverty rate of 9.3 instead of the 12.8 percent actually observed.

The primary reason for this divergence is deterioration in the ability of the poor to work their way out of poverty. Changes in the wage structure of the economy during the 1980s made it increasingly difficult to escape poverty through hard work. During the recent expansion, the poor worked more, but falling real wages offset the increased hours of work. The result was a much slower decline in poverty rates. Unless we devote substantially more attention to the labor market and the opportunities it provides for less skilled workers, growth alone will prove inadequate to the challenge of reducing poverty in the 1990s.

The weakening of the link between economic growth and progress against poverty does not mean that we must accept continued slow progress in dealing with poverty. Poverty rates move in response to policy changes as well as economic growth. Canada, our closest neighbor and most similar economic partner, has been able to make substantial progress against poverty during the past two decades, through macroeconomic growth but also because of an enhanced safety net that is particularly aimed at protecting families with children.

POVERTY AND THE ECONOMY

It is an axiom of public policy and political rhetoric that economic growth helps the poor. More than one president has claimed that "the best thing we can do for the poor is to make the economy grow." This strategy, often referred to as "trickling down," is extremely attractive, because it promises that we can fight poverty without substantial costs. Economic growth is expected to both make middle-income Americans better off and to decrease poverty at the same time. It's a no-lose solution to poverty. Unfortunately, it appears that the kind of economic growth we have experienced in recent years has lost much of its effectiveness in reducing the poverty rate.

Quite a bit of research evidence indicates that sustained economic growth was very important in the declining poverty rates of the 1960s and early 1970s. In the mid- to late-1970s, when growth slowed as the economy faced a series of recessions and external price shocks, progress against poverty declined.[1]

Between 1961 and 1970, the U.S. Economy experienced its longest economic boom. Poverty fell 9 percentage points. Between 1983 and 1990, the U.S. economy experienced its second-longest economic expansion. After the sharp recession of 1981/82, the poverty rate exceeded 15 percent and it would have been reasonable to expect that the strong expansion that followed would have produced a sharp decline in poverty. This did not occur. While poverty clearly declined over the expansion, it still stood at 12.8 percent in 1989, well above its historic low of 11.1 percent in 1973, and at about the same level as in 1980. The macroeconomic expansion did not bring down poverty as quickly as historical evidence would have indicated. In 1988, for instance, when the overall economy grew by more than 4 percent, poverty fell by a statistically insignificant amount.

In the mid-1980s, my colleague Alan Blinder, of Princeton University, and I attempted to estimate the relationship between macroeconomic indicators and the overall poverty rate. Using data from 1959 (when official poverty numbers begin) to 1983, we were able to track poverty quite closely, using the core unemployment rate, the inflation rate, the share of government transfers to GNP, and several other macroeconomic indicators. This relationship entirely fails, however, when used to forecast the poverty rate during the expansion of the 1980s.

If we take the historical relationship between the macroeconomy and poverty through 1983, estimated by Professor Blinder and myself, and use that relationship to predict the poverty level in 1989, using the actual macroeconomic date of the 1980s, we forecast a 1989 poverty rate of 9.3 percent. The actual poverty rate was 12.8 percent, much higher. Figure 1 indicates this divergence between poverty trends in the 1980s and historical experience. Figure 1 plots the actual poverty rate from 1959 to 1989, against the fitted values of our equation from 1959 to 1983 and the forecast values from 1984 to 1989. As Figure 1 indicates, the predicted values diverge steadily from the actual poverty rate throughout the expansion of the 1980s.

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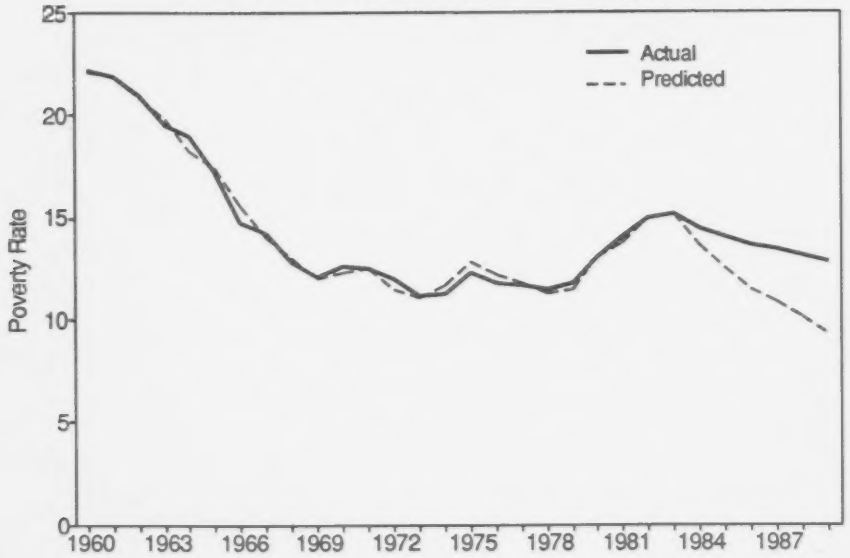
[1] Government transfer policy was also very important in these years. Had government transfers not increased over the 1970s, the deteriorating economy would have produced a much sharper rise in poverty than actually occurred.

Figure 1

Predicted vs. Actual U.S. Poverty Rates



EXPLAINING THE SLUGGISH DECLINE IN POVERTY

I have been involved in a major research project over the past year trying to explain why poverty fell so little in the expansion of the 1980s.[2] According to this research, many of the standard explanations offered for the sluggish decline in poverty turn out to lack explanatory power. Specifically:

(1) Problems in the measurement of income and poverty, particularly the exclusion of in-kind income from poverty measurement statistics. Poverty rates that count in-kind income decline by almost exactly the same amount over the expansion of the 1980s as do official rates. This is perhaps not surprising since in-kind income largely did not grow in real terms over this time period.

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[2] This project was funded by the Jerome Levy Economics Institute.

(2) The regional distribution of the poor. The poor and the non-poor were similarly located across regions and states. Thus, while the expansion of the 1980s was not as strong in all areas of the country, this did not disproportionately disadvantage poor families.

(3) The policy changes in transfer programs in the early 1980s. If the welfare programs of 1978 had been in effect in the late 1980s, the poverty rate would be virtually unchanged. It is true that welfare benefits fell in real terms over the 1980s. More poor families would receive more welfare income if the 1978 programs were still in effect, making them somewhat better off. But the differences are not large enough to move any substantial number of families across the poverty line.

(4) The changing demographic composition of the poor. Between the 1960s and the 1980s the composition of the poor changed; most notably a higher percent of poor families in the 1980s were single-parent families. If, however,the composition of the poor had remained identical from the early 1960s through the late 1980s, the poverty rate would have been just as unresponsive to the macroeconomy of the 1980s.

EARNINGS, WAGES AND POVERTY

So what did happen? The answer is that the earnings of heads of poor families grew much more slowly with the economic expansion of the 1980s than earnings did during the 1960s. Earnings are the product of wages times labor market involvement. Which of these two factors caused slower earnings growth in the 1980s?

As it turns out, labor market involvement was more responsive to economic growth during the 1980s than during the 1960s. Unemployment fell faster; weeks of work among low-income households expanded at a faster rate. Economic growth means new jobs and expanded employment opportunities. Traditionally, the poor have disproportionately gained during an economic expansion because they are most likely to be unemployed or underemployed. Thus, they can most benefit from expanded job opportunities. In the 1980s, low-income households took advantage of the growing labor market demand even more than they did in the 1960s. If we look only at labor market involvement, we would have expected poverty to fall faster in the 1980s.

The remaining factor is earnings. Among the poorest 10 percent of the population, which is entirely composed of families below the poverty line, real wages actually fell with economic growth. GNP growth of 1 percent in the expansion of the 1960s was correlated with a $2.18 increase in real weekly wages. GNP growth of 1 percent in the expansion of the 1980s, was correlated with a $.32 decrease in weekly wages. Near-poor families show similar patterns.

As the economy grew during the 1960s, low-income households worked more and their wages grew at the same time. The result was a rapid decline in poverty rates. In the 1980s, the poor worked more, but falling real wages offset the increased hours of work. The result was a much slower decline in poverty rates.

In short, "trickling down" didn't work very well in the 1980s because of flat or declining real wages among low-skilled workers. The distribution of wages has widened greatly over the 1980s. While wages fell for less-skilled workers, they increased sharply among more skilled workers. (In fact, wages rose more rapidly among high-income workers in the 1980s than in the 1960s.) There are a variety of causes for these trends: changes in technology, changes in international markets that have produced changes in the skill-mix of labor demand, and changes in the relative supply of more and less-skilled workers relative to the rapidly growing demand for more skilled workers by employers. All of these issues seem to be correlated with the declining wage opportunities for low-wage workers.

At this point, it is not clear how long-term these changes are or if these trends will continue into the 1990s. If they do continue, then we cannot rely upon economic growth to solve our current poverty problems. Even sustained economic growth—such as we had during the last 8 years of the 1980s—will do little to help the poor.

The policy implication of this is that we must address the labor market problems of this country. I strongly believe that among those who can work, employment is a better social and personal solution than long-term reliance on government assistance. When the jobs available to poor families pay less and less each year, however, it is hard to recommend work as a way out of poverty. We need to "make work pay" to use David Ellwood's much quoted phrase. This means ongoing attention to such strategies as the Earned Income Tax Credit, wage subsidies, education, and worker training.

Even as I've emphasized some of the labor market problems that have faced today's poor, however, I want to emphasize that we cannot ignore transfer programs either. While employment and job strategies are important, they are not sufficient in the short term.

THE CANADIAN EXPERIENCE

My best illustration of the potential effectiveness of transfer programs aimed at families with children comes from research I have completed comparing poverty programs and poverty rates in the United States and Canada.[3]

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[3] This is joint work with Maria Hanratty, currently at Cornell University, and was funded by the Donner Foundation.

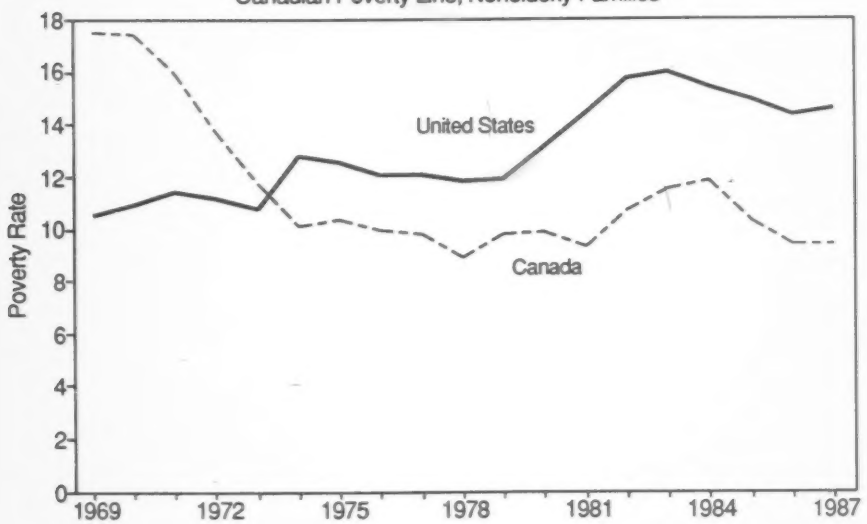
Comparisons between the United States and Canada are particularly interesting. Our populations and cultures are similar in many ways and our economies are closely linked. Yet, while the United States has faced stagnating poverty rates—our current poverty rate is essentially the same as it was 2 decades ago in 1970—Canadian poverty has declined.

In 1970, Canada had a substantially higher poverty rate than the United States. Over the next two decades, the U.S. poverty rate showed no trend, but Canadian poverty fell by more than 50 percent, so that it is now substantially below the U.S. rate. Figure 2 shows the different trends in U.S. and Canadian poverty rates. (Note that the comparison in Figure 2 is based on a comparable definition of poverty in both countries, as well as an adjustment for purchasing differences between the Canadian and the U.S. dollar. The poverty rates in Figure 2 are based on the Canadian low-income cutoff rather than the U.S. poverty definition because of data availability. If the U.S. definition were used, the levels would change but the trends would be identical.)

Figure 2

Canadian vs. U.S. Poverty Rates

Canadian Poverty Line, Nonelderly Families



Over the 1970s, the Canadian decline in poverty was almost entirely due to stronger macroeconomic growth. Canada was not as badly affected by the initial oil price shock in 1973. Both the poor and the non-poor continued to experience strong increases in real income throughout the early 1970s, while U.S. real income began to stagnate. In these years, "trickle down" worked in Canada as well as it had worked in the United States in the 1960s.

Over the 1980s, however, the story is quite different. Canadian poverty rates have continued to decline over this decade. This is not because of a stronger macro-economy. In fact, if anything, Canada's economy has been weaker than the United States' in the 1980s. Family income, excluding government assistance payments, moved almost identically in the two countries. Canada remains a poorer country than the U.S. But it has fewer poor families, and those who are poor have higher average incomes than the U.S. poor.

What has Canada done over the 1980s that the U.S. did not do? In the United States, public assistance benefits fell during the 1980s, while they expanded in Canada. This is particularly noticeable when comparing child poverty in the two countries. Poverty rates among Canadian families with children—particularly single-parent families—are substantially lower than in the United States. Among female-headed families, equivalent poverty rates are one-third lower. The difference is almost entirely due to Canada's more generous public assistance system. In fact, it is worth noting that labor market involvement among female family heads—the group who benefit the most from higher public assistance payments in Canada—is virtually identical in the two countries.

A comparison of anti-poverty efforts in the United States and Canada is particularly interesting because in many ways these two countries are quite similar. Social Assistance—the primary welfare program in Canada—is run entirely at the provincial (and even municipal) level, unlike the nationalized welfare programs of many European countries. (Canada does have a nationalized health-care system, however.) The result is large provincial differences in the public assistance income provided to poor families on Social Assistance, similar to the differences within the United States in the state-run Aid to Families with Dependent Children program.

The Canadian anti-poverty system is different from the U.S. system, however, in at least two important ways. First, benefit levels are higher. The support available from the least generous province is equivalent to the support available from the most generous state. Second, Canada supplements its Social Assistance program with two additional inflation-indexed programs aimed at families with children: They provide a refundable tax credit to all low-income families. (Unlike the Earned Income Tax Credit, this is not tied to labor force participation.) Second, the Canadian federal government mails a Family Allowance check to all families with children, regardless of income. Although neither of these programs provide a great deal of money, a poor family with two children might annually receive close to $1,500 (US) additional income from them—a substantial advantage to a household whose income is near or below $10,000 a year.

There is clearly nothing inevitable about the current U.S. poverty rates, particularly the rate among children in this country. Canada has been able to make continuing progress against poverty, even as they have faced the same macroeconomic problems as this country in the 1980s. We, too, could reduce poverty among children by enacting some form of a child allowance payment in the United States, available to all low-income families. The National Commission on Children, headed by Senator Rockefeller, made a similar proposal recently. Even small annual supplements, based on the number of children, can make a difference in very poor families, as Canada's program shows.

CONCLUSION

The last decade has taught us that there are no simple solutions to poverty in this country. Overall economic growth has not been very effective in reducing poverty over the last decade, due to shifts in the wage structure of the country that have increasingly disadvantaged low-skilled workers. This leaves us with two options, both of which we must continue to pursue:

- First, we need effective transfer systems for those who cannot work, or whose involvement with the labor market is not sufficient for support of their families. Some form of a child allowance is one direction to move.

- Second, we need to be sure that there are incentives for employment for those who can and should work. This means serious attention to our drop-out rate, to the skills and literacy of children from poor schools, to adult training and employment programs, and to income supplements, like the Earned Income Tax Credit and/or other wage subsidy schemes.

Our progress against poverty was lower in the 1980s than it should have been. The poor gained little from the macroeconomic expansion of the last decade because of demand shifts away from low-skilled workers that depressed wages. Real public assistance benefits also fell, and poverty among children rose. To assure that the 1990s do not repeat the failures of the 1980s, we need to act now.